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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 539

BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 15–16) is reported at 345 F. 2d 624. The earlier decision of the court of appeals, vacating a judgment in favor of the United States and remanding to the district court (Pet. App. 5–8), is reported at 317 F. 2d 859. The opinion of the district court on remand (R. 21–27; Pet. App. 9–14) is reported at 229 F. Supp. 906.

JURISDICTION

The judgment of the court of appeals was entered on May 13, 1965. On August 8, 1965, Mr. Justice Douglas extended the time for filing a petition for a

writ of certiorari to and including September 10, 1965. The petition was filed on September 7, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a bank may defeat a levy upon the taxpayer's bank accounts by a claim to a setoff for a debt incurred after the federal tax lien was recorded.

STATUTES INVOLVED

Internal Revenue Code of 1954:

SEC. 6321. [26 U.S.C. 6321] LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

SEC. 6331. [26 U.S.C. 6331] LEVY AND DISTRAINT.

(a) *Authority of Secretary or Delegate.*—If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a

lien provided in this chapter for the payment of such tax. * * *

(b) *Seizure and Sale of Property.*—The term "levy" as used in this title includes the power of distraint and seizure by any means. In any case in which the Secretary or his delegate may levy upon property or rights to property, he may seize and sell such property or rights to property (whether real or personal, tangible or intangible).

* * * * *

SEC. 6332. [26 U.S.C. 6332] SURRENDER OF PROPERTY SUBJECT TO LEVY.

(a) *Requirement.*—Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary or his delegate, surrender such property or rights (or discharge such obligation) to the Secretary or his delegate, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process.

(b) *Penalty for Violation.*—Any person who fails or refuses to surrender as required by subsection (a) any property or rights to property, subject to levy, upon demand by the Secretary or his delegate, shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the taxes for the collection of which such levy has been made, together with costs and interest on such sum at the rate of 6 percent per annum from the date of such levy.

* * * * *

Code of Civil Procedure, 14 West's Annotated California Codes:

§ 440. *Counterclaim; compensated demands; effect of assignment or death*

When cross-demands have existed between persons under such circumstances that, if one had brought an action against the other, a counterclaim could have been set up, the two demands shall be deemed compensated, so far as they equal each other, and neither can be deprived of the benefit thereof by the assignment or death of the other.

STATEMENT

The United States brought this action under Section 6332(b) of the 1954 Code (*supra*, p. 3) to collect the amount of a tax levy served on petitioner pursuant to Section 6332(a) (*supra*, p. 3). The government's complaint alleged (R. 3–6),[1] and the trial court found, that at the time of the levy, petitioner held property of taxpayer J. B. Edmondson which was subject to prior federal tax liens. On the first appeal, the court of appeals reversed on the ground that the stipulation as to the facts was inadequate (Pet. App. 5–8). On remand, a fuller stipulation of facts was agreed to and the district court again found in favor of the government (R. 8–18, 21–27). The court of appeals affirmed *per curiam* (Pet. App. 15–16).

On various dates in 1955, federal withholding and Federal Insurance Contributions Act taxes were as-

[1] "R." refers to the printed record in the court below in No. 19,469.

sessed against J. B. Edmondson, of which $8,374.44 remained unpaid at the time of trial. The taxpayer was served with notice and demand for payment of such taxes, and notices of federal tax liens were duly filed in Orange County, California, on October 19, 1955, as to the assessment for the first quarter of 1955, and on January 28, 1958, as to the assessments for the second and third quarters of 1955 (R. 9–10). On August 27, 1959, the District Director served petitioner with a notice of levy and a demand for payment of all amounts petitioner was then holding in the taxpayer's checking and savings accounts, to the extent of unpaid taxes (R. 10). On the date of the levy, petitioner's books showed that the taxpayer had deposits to his credit in several commercial checking accounts and one savings account totaling $6,658.31 (R. 11). The commercial accounts were active accounts, into which deposits were made and upon which checks were drawn by the taxpayer up to the date of the levy (R. 12–13).

On August 27, 1959, the taxpayer was indebted to petitioner in the amount of $11,570.40 on several notes. All of these notes were executed after January 28, 1958, the date the latest notices of federal tax liens were filed (R. 13–17). On August 28, 1959, the day after receiving the notice of levy, petitioner made entries on its books purporting to credit the $6,658.31 balance then standing in the taxpayer's checking and savings accounts against his obligations under the notes (R. 17).

Petitioner defended its refusal to make the payments demanded in the government's levy on the ground,

among others,[2] that the amounts shown on its books to the taxpayer's credit on the date of levy had been automatically extinguished at the instant of deposit by operation of California Code of Civil Procedure § 440 (*supra*, p. 4), and that, therefore, the deposits were no longer in existence on August 27, 1959. Relying primarily on *Bank of Nevada* v. *United States*, 251 F. 2d 820 (C.A. 9), certiorari denied, 356 U.S. 938, the district court, on two occasions,[3] and the court of appeals rejected petitioner's contention.

ARGUMENT

This case presents only a question of California law, which was correctly decided in the courts below. Petitioner contends that, under California law, it had no "property [or] rights to property" belonging to the

[2] Petitioner has abandoned any claim that it was entitled to actual notice of the federal tax liens before making the loans to the taxpayer as well as any claim to a banker's lien under California Civil Code § 3054.

[3] The first opinion of the district court, which is unreported, reads in pertinent part as follows:

> Counsel for defendant Bank have made a strong argument in the face of a difficult set of facts. Acceptance of the position they have advocated, however, would result in a situation where, by virtue of state law, California banks could gain advantage by purposely avoiding procedures that would inform them of preexisting federal tax liens, such as the examination of county lien records. California banks, by avoiding notice, could make loans and accept deposits subsequent to the filing of federal tax liens and then, even after notice of levy of the tax lien, could effect a setoff without any liability to the federal government. This result could not be reached under the reasoning of *Bank of Nevada* v. *United States*, 251 F. 2d 820 (9th Cir 1957). * * *

taxpayer at the time of the government's levy. There is no contention, as indeed there cannot be, that a bank account in California is not the kind of property which is subject to a lien under Section 6321 of the 1954 Code (*supra*, p. 2). See *MacKenzie* v. *United States*, 109 F. 2d 540, 542 (C.A. 9). Nor does petitioner appear to dispute the proposition that the right to a setoff for debts arising after the recording of a federal tax lien does not take priority over the lien.[4] See *e.g.*, *Bank of Nevada* v. *United States*, 251 F. 2d 820, 824–827 (C.A. 9), certiorari denied, 356 U.S. 938; *United States* v. *Graham*, 96 F. Supp. 318 (S.D. Calif.), affirmed *per curiam sub nom. California* v. *United States*, 195 F. 2d 530 (C.A. 9), certiorari denied, 344 U.S. 831. Its contention basically is that California Code of Civil Procedure § 440 is not "a mere 'statutory

[4] Petitioner asserts (Pet. 13, n. 8) that the decision below and that in *Bank of Nevada* conflict with decisions "upholding the right of setoff in the face of a federal tax lien." But none of the cases relied on are apposite here. In *United States* v. *Bank of Shelby*, 68 F. 2d 538 (C.A. 5), and *United States* v. *Bank of United States*, 5 F. Supp. 942 (S.D.N.Y.), the setoff rights were for debts which arose and matured before the federal tax lien was recorded. *United States* v. *Long Island Drug Co.*, 115 F. 2d 983 (C.A. 2), held a tax lien subordinate to a later-arising debt on the theory that the tax lien could not attach to future earnings. This Court expressly disapproved that theory in *Glass City Bank* v. *United States*, 326 U.S. 265, 267. In *Karno-Smith Co.* v. *Maloney*, 112 F. 2d 690 (C.A. 3), as well as *Aquilino* v. *United States*, 363 U.S. 509, and *United States* v. *Durham Lumber Co.*, 363 U.S. 522, also cited by petitioner, it was held that a defaulting contractor acquired no interest in payments due under the contract against which the government asserted a tax lien. Similarly, *In re Halprin*, 280 F. 2d 407 (C.A. 3) held that the taxpayer acquired no interest in payments under a contract until the party financing the work had been paid.

right of setoff under state law'" (Pet. 12) but is "an extra-judicial, non-volitional extinction of cross-demands" (Pet. 8).

We submit that the courts below, and not petitioner, have correctly apprehended the California law applicable to this case. Petitioner seeks to disparage the district court's application of Section 440 by noting that the court described the provision as a "statutory right of setoff" (Pet. 12), but the California courts have described the provision in the same terms. See, *e.g.*, *Ainsworth* v. *Bank of California*, 119 Cal. 470, 475, 51 Pac. 952, 953 ("our statute of setoff"); *Murchison* v. *Murchison*, 219 Cal. App. 2d 600, 605 (Dist. Ct. App.) ("[t]his principle of setoff"); cf. *Salladin* v. *Mitchell*, 42 Neb. 859, 862, 61 N.W. 127, 128 (construing substantially identical Nebraska statute). The fact that Section 440 is derived from the civil law and is traceable to the Roman law of *compensatio* (Pet. 8) does not preclude its application in the same manner as an equitable setoff so far as the issue involved here is concerned. To the contrary, the civil law developed a specific restriction on *compensatio* to the effect that a bank may not automatically extinguish a general deposit and credit it against a past due note. See Comment, *Automatic Extinction of Cross-Demands:* Compensatio *From Rome to California*, 53 Calif. L. Rev. 224, 276; Comment, *The Right of a Bank Depositor in Louisiana To Compensate His Debt to the Bank*, 8 Tul. L. Rev. 423, 427 & n. 26.

It is well settled in California and elsewhere that the right to setoff, under Section 440 or on general

equitable principles, does not defeat third parties' otherwise superior interests in the property claimed to have been set off or "compensated." *Keck* v. *Keck*, 219 Cal. 316, 26 P. 2d 300 (alimony rights); *Roberts* v. *Spires*, 195 Cal. 267, 232 Pac. 708 (subcontractors' liens); *Walters* v. *Bank of America National Trust & Savings Association*, 9 Cal. 2d 46, 54–57, 69 P. 2d 839 (garnishment); *United States* v. *Graham*, 96 F. Supp. 318 (S.D. Calif.), affirmed *per curiam sub nom. California* v. *United States*, 195 F. 2d 530 (C.A. 9), certiorari denied, 344 U.S. 831 (tax liens); cf. *Middle Atlantic Credit Corp.* v. *First Pennsylvania Banking & Trust Co.*, 199 Pa. Super. 456, 185 A. 2d 818 (factors' liens). None of the California cases cited by petitioner involved third-party interests, but the comprehensive law review comment on Section 440 relied on by petitioner (Pet. 8) expressly recognizes that "[f]unds subject to liens may not be compensated away" (53 Calif. L. Rev. at 276) and accepts the district court's decision in the case at bar as wholly consonant with California law on the limitations of Section 440 (*id.* at 277).

Petitioner's contention that the taxpayer's deposits were extinguished at the instant they were made is belied by the fact that the deposits continued to appear on petitioner's books and the taxpayer continued to use his accounts after his deposits were made and his obligations to petitioner were in default. The crucial determination for federal tax lien purposes is whether, at the time of the levy, the deposits were in reality being held in the taxpayer's accounts. Conceptual extinction of the deposits under the doctrines

of compensation and relation back is of no consequence here. *United States* v. *Security Trust & Savings Bank*, 340 U.S. 47, 50; *United States* v. *Allen*, 328 F. 2d 377 (C.A. 5).

There is no substance in petitioner's assertion that the decision below will have a serious adverse effect on California banks. The banks are not embarrassed in any respect by the present decision. At the most, the decision might lead them to inquire into the existence of tax liens before extending credit.[6] The primary effect of the decision below is to afford the United States the same right as any private lien creditor to priority over banks' later-arising claims to their customers' deposits. The reading petitioner seeks to give Section 6340, on the other hand, would result in impossible bookkeeping problems for banks and their borrower-customers. See Comment, *supra*, 53 Calif. L. Rev. at 276.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

THURGOOD MARSHALL,
Solicitor General.
RICHARD M. ROBERTS,
Acting Assistant Attorney General.
JOSEPH KOVNER,
FREDERICK E. YOUNGMAN,
Attorneys.

OCTOBER 1965.

[6] In the present case, the loans made by petitioner to the taxpayer were, for the most part, secured by prime liens on new property, purchased under conditional sales arrangements, in which only the taxpayer's equity is subject to federal tax liens.

U.S. GOVERNMENT PRINTING OFFICE: 1965